

FILED
U.S. BANKRUPTCY COURT
WESTERN DISTRICT OF NC

AUG 01 1994

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

J. BARON GROSHON
By
Deputy Clerk

In Re:)	Case No. 90-31214
)	CHAPTER 13
REGINALD GAINER,)	
)	
Debtor.)	JUDGMENT ENTERED ON AUG 01 1994
_____)	

ORDER REGARDING DISPENSATION OF INSURANCE PROCEEDS

This matter is before the court on the Debtor's Motion for Order Allowing Disbursement of Insurance Proceeds, Free and Clear of Liens, and Requiring Removal of Lien from Title to Automobile. This matter was initially heard on May 24, 1994. Further Argument was heard on June 28, 1994.

JURISDICTION

The court has jurisdiction in this matter pursuant to 28 U.S.C. § 157 and the Referral Order entered by the judges of the United States District Court for the Western District of North Carolina on July 30, 1984, pursuant to the Bankruptcy Amendments and Federal Judgeship Act of 1984. The court has subject matter jurisdiction under 28 U.S.C. § 1334. This is a core proceeding under 28 U.S.C. § 157(b)(2). Venue is properly with this court pursuant to 28 U.S.C. § 1409.

BACKGROUND

Prior to filing bankruptcy, the debtor purchased a 1988 Pontiac Sunbird (the "automobile"). General Motors Acceptance Corporation ("GMAC") provided the financing for this purchase. In August of 1990, Reginald W. Gainer filed his chapter 13 bankruptcy petition. The debtor's petition listed GMAC as a creditor whose debt of approximately \$10,000 was partially secured by the automobile. GMAC, on account of its claim against the debtor, was for plan purposes given a secured claim of \$6,500 and an unsecured general claim of \$3,482.34.

In early May of 1994, the automobile was totally destroyed in an accident. Insurance proceeds have been tendered in the amount of \$ 3,630.50. The present dispute focuses upon who should receive the insurance proceeds. One possibility is that the insurance proceeds, which constitute property of the estate, be sent to the chapter 13 trustee to be distributed amongst the existing creditors. A second possibility is that the debtor be allowed to receive these proceeds and apply them towards a new automobile. A final alternative is that GMAC, whose secured claim has been paid in full through the plan, receive the proceeds under the rationale that they, if anyone, should profit from this windfall as it was their collateral which was destroyed. The debtor counters GMAC's proposal on the grounds that if in fact GMAC's secured claim has been paid in full, GMAC has no interest in the insurance proceeds. The debtor further contends that GMAC

should immediately cancel its lien on the title of the automobile.

DISCUSSION

I. Chapter 13 lien stripping

The issue of lien stripping became a hotbed of judicial activity following the United States Supreme Court decision in Dewsnup v. Timm, ___ U.S. ___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992) which held that a chapter 7 debtor could not "strip down" a creditor's lien on real property to the judicially determined value where the creditor's claim is secured by a lien and has been fully allowed pursuant to 11 U.S.C. § 502. A split of authority exists on whether Dewsnup's "no strip down" rule should be confined to chapter 7 real property cases or whether the "no strip down" rule should be extended to chapter 13 cases, as well. Lower courts are quick to point out that Dewsnup specifically limited its holding to the particular facts at hand, without suggesting a broader application. In noting the difficulty of addressing potential scenarios, the Supreme Court stated "[w]e therefore focus upon the case before us and allow other facts to await their legal resolution on another day." Dewsnup, 112 S.Ct at 778.

That day has come for numerous lower courts which have now addressed these cases whose facts slightly vary from those contained in Dewsnup. Courts have struggled in their efforts to extrapolate from Dewsnup. Consequently, lower courts have arrived at diametrically opposed decisions on the issue of lien stripping.

Most courts do, however, begin at the same point in analyzing the secured status of a creditor-- i.e., by referring to 11 U.S.C. § 506, which states:

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest. . . .

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless--

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 506(a), (d). These two quoted paragraphs from section 506 serve different functions. Section 506(a) is referred to as the security reducing provision. It is this section from which claims are bifurcated into the secured and unsecured

portions. Bifurcation occurs in the early phases of a bankruptcy proceeding. Section 506(d) is referred to as the lien avoidance section. It is this section which actually voids the lien. Courts differ as to the time at which section 506(d) can be invoked. Some courts advocate that section 506(d) can be applied prior to the completion of the plan, whereas other courts maintain that the avoidance of a lien through the operation of section 506(d) can only occur at the completion of a chapter 13 plan.

In a chapter 13 case, there is an additional provision which many courts address in determining the secured status of a creditor. Section 1322(b)(2) provides that a chapter 13 plan may:

[M]odify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

11 U.S.C. § 1322(b)(2). Some courts conclude that the presence of this provision specifically allows a chapter 13 debtor to strip down the lien rights of a creditor who retains a security interest in personal property. Note that our case involves a lien in personal property (i.e., an automobile), as opposed to a mortgage in the debtor's residence, and therefore is differentiated from the concerns and analysis contained in Nobelman v. American Savings Bank, __ U.S. __, 113 S.Ct. 2106 (1993) (chapter 13 debtor unable to utilize § 1322(b)(2) to modify rights of holder of claim secured solely by debtor's residence).

Not all courts accept this view, especially in light of the strong prohibition against lien stripping found in Dewsnup. In re Hernandez, 162 B.R. 160 (Bankr. N.D. Ill. 1993) held that a debtor, despite the language found in section 1322(b)(2), could not strip down a creditor's lien pursuant to section 506(d). Hernandez held that a debtor could utilize section 506(a) to bifurcate the claim into secured and unsecured portions, but could not void the lien rights of the creditor. As a result, the creditor, after the completion of the chapter 13 plan, would retain its full security interest, although the personal obligation of the debtor would have been discharged.

As noted above, there is ample authority holding that a chapter 13 debtor is entitled to void, as well as bifurcate, an undersecured claim. The Third Circuit, in Sapos v. Provident Institution of Savings in the Town of Boston, 967 F.2d 918, 921 (3rd Cir. 1992), held that section 506(a) allows the "debtor to 'cram down' an undersecured claim to reflect the present value of the collateral." Sapos analyzed whether the Dewsnup decision would prevent the modification of a creditor's rights in a chapter 13 reorganization, notwithstanding section 1322(b)(2), and held that the Dewsnup Court's reasoning was confined to chapter 7 liquidations, and did not govern chapter 13 reorganizations. Sapos, 967 F.2d at 925. See In re McDade, 148 B.R. 42 (S.D. Ill. 1992)(following Sapos in limiting Dewsnup to chapter 7 real property lien situations and therefore allowing a chapter 13

debtor to strip down an undersecured automobile lien, pursuant to §§ 506(a), 506(d) and 1322 (b)(2)).

This court, after careful deliberations, follows this line of reasoning and finds that a chapter 13 debtor is entitled to bifurcate an undersecured lien pursuant to § 506(a) and void such unsecured portion pursuant to § 506(d) in situations not raising the Nobleman concerns noted above.

II. Timing of the chapter 13 lien avoidance

Finding that a chapter 13 debtor can strip down a claim is only the initial step in our analysis. The timing issue -- i.e., when exactly a lien can be avoided -- is equally crucial. Some courts have held that once the secured portion of a creditor's bifurcated claim has been paid, that creditor's lien rights immediately cease to exist. In re Murry-Hudson, 147 B.R. 960 (Bankr. N.D. Cal. 1992), is a leading case supporting this position. Murry-Hudson took a very trusting view towards debtors in allowing them to obtain clean certificates of title to their vehicles prior to the completion of their plan. The creditor argued that allowing the debtor a clean title prior to plan completion would entice debtors to abuse the system. Potentially, a debtor could bifurcate the creditor's claim, pay only the secured portion, demand the creditor remove their lien from the car's title, and then immediately dismiss their bankruptcy case--leaving the creditor the unenviable task of tracking down the

debtor in hopes of again placing a lien on the vehicle. The Murry-Hudson court scoffed at such alleged "mischief by unscrupulous debtors" and stated that:

The concerns [the creditor] raises regarding the possibility that debtors might dismiss or convert their Chapter 13 plans shortly after paying off their allowed secured claims and receiving their certificates of title for their automobiles appear more illusory than real.

Murry-Hudson, 147 B.R. at 961-962. See In re Lee, 162 B.R. 217 (D. Minn. 1993) (court upheld debtor's plan allowing collateral to fully vest in the debtor free and clear of any lien, prior to completion of plan, upon the payment of creditor's secured claim); Cf. In re Pickett, 151 B.R. 471 (Bankr. M.D. TN 1992) (creditor not entitled to relief from stay on grounds that payment of secured claim in chapter 13 case extinguished lien as a matter of law and such lien was not revived upon conversion to chapter 7; therefore, there was no lien upon which relief from stay in the chapter 7 could be granted).

Many courts openly disagree with this line of reasoning and exhibit far more skepticism and caution in the incentives they place before debtors. Numerous courts fear the possibility of debtors converting or dismissing their cases prior to the completion of their chapter 13 plan. In re Jordan, 164 B.R. 89, 92 (Bankr. E.D. Mo. 1994), determined that allowing a debtor to void a creditor's lien prior to plan completion would "provide an incentive to convert the moment the secured portion of the bifurcated claim is paid in full." Jordan warned that such incentives "would promote abuse of the bankruptcy process." Id.

A common solution is to allow the debtor to bifurcate the claim immediately, but postpone any lien avoidance until plan completion. In re Gibbons, 164 B.R. 207 (Bankr. D.N.H. 1993), expressly adopts this procedure for lien avoidance in stating:

[A]ny voiding of the lien could no occur until the debtors have fully performed their plan, and that any order providing for the avoidance of a lien would have to be contingent upon full performance of the plan

Id. at 208. Likewise, In re Jones, 152 B.R. 155 (E.D. Mich. 1993) advocates for the postponement of lien avoidance under § 506(d) until plan consummation.

Jones specifically doubted Murry-Hudson's conclusion that the good faith, best interests and feasibility tests found in 11 U.S.C. § 1325(a)(3), (4), and (6), respectively, constituted protections justifying lien avoidance prior to plan completion. The court in Jones stated "[we] do not believe that these safeguards substantially protect creditors in the way the Murry-Hudson suggests." Jones, 152 B.R. at 181.

In re McDonough, 166 B.R. 9 (Bankr. D. Mass. 1994), echoed this sentiment in stating:

[L]ienstripping should only be accomplished through the Plan itself, which does not provide a benefit to the Debtor until the Debtor obtains a discharge under 11 U.S.C. § 1328, and it is certain that the case will be neither dismissed or converted.

McDonough, 166 B.R. at 14 (emphasis in original). See In re Hirsch, 155 B.R. 688, 691 (Bankr. E.D. Pa. 1993) (court allowed chapter 13 debtor to strip down creditor's claim only upon express condition that the debtor achieve confirmation of the

plan, the debtor ultimately receive a discharge in that plan, and the secured claim be paid pursuant to 11 U.S.C. § 1325(a)(5)(B)), vacated on other grounds, 166 B.R. 248 (E.D. Pa. 1994).¹

It is this latter line of reasoning which the court finds persuasive. In order to adequately protect the creditor and to preserve the integrity of the system, this court will delay the actual lien avoidance until the time at which the chapter 13 plan is completed and the debtor receives a discharge.

III. Debtor's Motion for Order Allowing Disbursement of Proceeds, Free and Clear of Liens, and Requiring Removal of Lien from Title to Automobile.

Upon filing this chapter 13 proceeding, the debtor, Reginald Gainer, owed a debt to GMAC of approximately \$10,000, for which GMAC held a security interest in the debtor's automobile. The amount of debt exceeded the value of the collateral at the time of the petition. The debtor sought to bifurcate GMAC's claim into secured and unsecured portions pursuant to 11 U.S.C. § 506(a). GMAC was for plan purposes given a secured claim of \$6,500 and an unsecured general claim of \$3,482.34. The court

¹11 U.S.C § 1325(a)(5)(B) provides that a chapter 13 plan can be confirmed over the secured creditor's objection if (i) the creditor retains the lien securing the claim and (ii) the creditor receives under the plan value not less than the allowed amount of this secured claim. The legislative history makes clear that the § 1325(a)(5)(B)(ii) allowed secured claim valuation is determined by § 506(a). See H.R.Rep. No. 595, 95th Cong., 1st Sess. 430 (1977); U.S. Code Cong. & Admin. News 1978, pp. 5787, 6385; McDonough, supra, 166 B.R. at 13 (concluding that §§ 1322(b), 1325, & 506 empowers chapter 13 debtors to strip down liens falling outside the Nobelman exception).

agrees with the debtor that bifurcation of the claim at this stage was proper.

Prior to the destruction of the collateral via the automobile accident, the debtor had paid off the secured portion of GMAC's claim through the regular chapter 13 payments. Fortunately, the vehicle was insured at the time of the accident and the dispute has now shifted from the automobile to the insurance proceeds.

The debtor contends that GMAC no longer has any lien rights against the automobile or the proceeds on the grounds that the secured portion of GMAC's bifurcated claim has been paid in full and that § 506(d) has voided the unsecured portion of GMAC's original lien. As such, the debtor demands not only the proceeds, but also the removal of GMAC's lien from the debtor's certificate of title.

This court cannot agree with the debtor's assertion as to the timing of any lien avoidance. As discussed above, any such lien avoidance occurs only at the completion of the chapter 13 plan. Any lien avoidance attempt at an earlier stage in this proceeding will be denied as premature. Accordingly, the debtor's request to have GMAC's lien removed from the certificate of title prior to the completion of the debtor's plan is hereby denied.

The debtor also requests that he receive the insurance proceeds, free and clear of GMAC's lien. The debtor proposes to use the proceeds to obtain another automobile. The debtor

maintains that due to the destruction of his previous automobile, a substitute vehicle is needed if he is to effectuate his proposed chapter 13 plan. The court agrees that the debtor's request is not only legitimate, but also in the best interests of the creditors in this case. Therefore, the debtor is hereby allowed to receive the insurance proceeds for the sole purpose of obtaining another substitute vehicle.

The debtor further requests that GMAC's lien not attach to the proceeds on the grounds that GMAC no longer has a lien in this matter. As discussed above, GMAC's lien will not be avoided until the plan is completed. Although the secured portion of GMAC's claim has been fully paid, there is no assurance that the case will not be dismissed -- a result which would leave the creditor with a lien for the full amount of the debt, less the payments received during the plan. Understandably, it would be premature to label GMAC's lien as non-existent. Rather, GMAC's lien attaches to the insurance proceeds and subsequently to the substitute vehicle acquired. GMAC is entitled to the notation of its transferred lien upon the certificate of title to this substitute vehicle. The debtor, having already paid the secured portion of GMAC's bifurcated claim, is entitled to the removal of GMAC's lien from the certificate of title upon the completion of this chapter 13 plan and receipt of discharge.

There is one further scenario which must be addressed -- i.e., what happens if the insurance proceeds are not exhausted in obtaining this substitute vehicle, leaving "excess proceeds". As

discussed above, the insurance proceeds are property of the estate. These proceeds also represent the cash collateral into which the debtor's wrecked automobile has been converted. GMAC's lien, which originally attached to that particular automobile, is now transferred to these proceeds. As the debtor converts the insurance proceeds into a substitute vehicle, GMAC's lien will correspondingly be transferred to this substitute vehicle. In the event any of the cash collateral is not used in the acquisition of this substitute vehicle, GMAC will retain its lien in such "excess proceeds". In the event cash collateral remains following the acquisition of a substitute vehicle, 11 U.S.C. § 363 shall govern the use of such cash collateral and the adequacy of protection afforded to GMAC's lien in this cash collateral.

CONCLUSION

The court hereby ORDERS the following:

1. The insurance proceeds constitute property of the estate;
2. Prior to the debtor's acquisition of a substitute vehicle, GMAC's lien attaches to the insurance proceeds;
3. Upon the debtor's acquisition of a substitute vehicle, GMAC's lien is transferred to this substitute vehicle and GMAC's lien is to be noted upon this vehicle's certificate of title;
4. GMAC's will retain a security interest in any insurance proceeds not used in the acquisition of the substitute vehicle;
5. The use of such "excess proceeds" and the preservation of GMAC's lien in these proceeds shall be governed by 11 U.S.C. § 363;

6. The debtor is entitled to bifurcate GMAC's claim into secured and unsecured portions;

7. Upon the debtor's completion of this chapter 13 proceeding and receipt of discharge, GMAC is instructed to remove its lien from the substitute vehicle's certificate of title; furthermore, GMAC's lien in the "excess proceeds" will cease to exist upon the debtor's completion of this chapter 13 plan and receipt of discharge.

This the 27th day of July, 1994.



George R. Hodges
United States Bankruptcy Judge